The pre-retirement years

We see creating and looking after your wealth as a lifelong commitment. That's why we offer regular financial advice and guidance throughout the different stages in your life. Together, we can build the financial wealth that lets you enjoy the truly important things in your life.

Financial priorities: Super, super, super

Life motto: What mid-life crisis?

During pre-retirement years, superannuation 'suddenly' becomes a major focus – retirement is just around the corner! Money that once went into a mortgage now goes into wealth accumulation as we start thinking about the lifestyle we want in retirement.

For some, this stage of life may start at 45 or 50, while for others the pre-retirement years may start at 55, 60, or even later, depending on when they plan to retire.

Case study: Andrew and Joan Stanton

Ages: Andrew, 55 years old; Joan, 52 years old

Occupations: Andrew, scientist; Joan, voluntary work

Children: Janet, 30 years old; David, 28 years old; Felicity, 24 years old

Salary: Andrew, $90,000 a year

Assets:
Home $400,000
Share portfolio $100,000
Superannuation (Andrew) $250,000
Superannuation (Joan) $50,000
Debts: None

Financial goals: Accumulate wealth for retirement and provide for our children

'I want to retire in about five years' time and we want to enjoy our retirement. It's also important to us that we set up our children financially.'

Recommendations/strategies from wealth adviser

There are two questions Andrew and Joan need to think about in terms of retirement preparation:

- How much money do they need to fund their desired lifestyle?
- Will they outlive their money?

Two factors affect these questions: life expectancy and inflation. While it is impossible to know to what age Joan and Andrew will live, we know

What is wealth advice?

Wealth advice is support and guidance on the best way to manage all your finances. Whether it's adjusting your debts to minimise repayments, saving for a home or a holiday, investing money, planning for your retirement, maximising pension entitlements or ensuring your family are protected if something happens to you, the right advice from the right people will help you achieve your goals faster and more effectively.

that life expectancies are increasing. For example, in 1961, a 65 year-old Australian man could expect to live, on average, to 76 and a woman to 81. But now, a 65 year-old Australian man can expect to live until around 83 and a female until around 86.

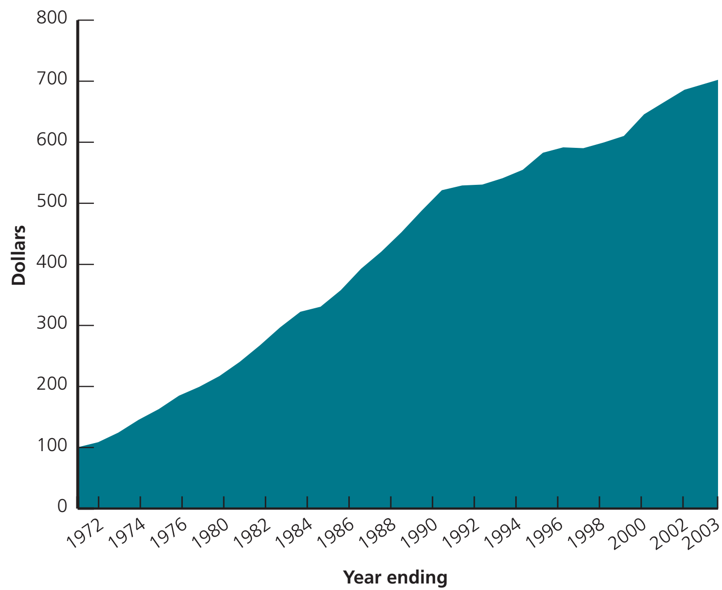
This increased life expectancy also means that inflation (the rising cost of living) can have a greater impact on retirement savings. The chart (right) demonstrates the fact that an item that cost $100 in 1972 would cost around $700 today.

Have they got enough?

Given that Andrew wants to retire at 60 and they want to set up their children financially, one option for Andrew and Joan is to ensure that they have enough money to invest so they can live off the interest (income) alone. Then, the lump sum could be left to their children, along with their house and other assets.

The graph below shows the lump sum and resultant income/year, assuming an investment return of 6%.

Andrew and Joan want around $40,000 per year – that means they need to end up with a lump sum of just under $670,000.



Source: RBA

Their current assets are:

Combined superannuation	$300,000
Shares	$100,000
Family home	$400,000
Total	**$800,000**

Their current assets would meet their needs, however Andrew and Joan would have to sell their home – something they don't want to do. If we take their family home out of the equation, they need to accumulate $270,000 in the next five years. Other options include:

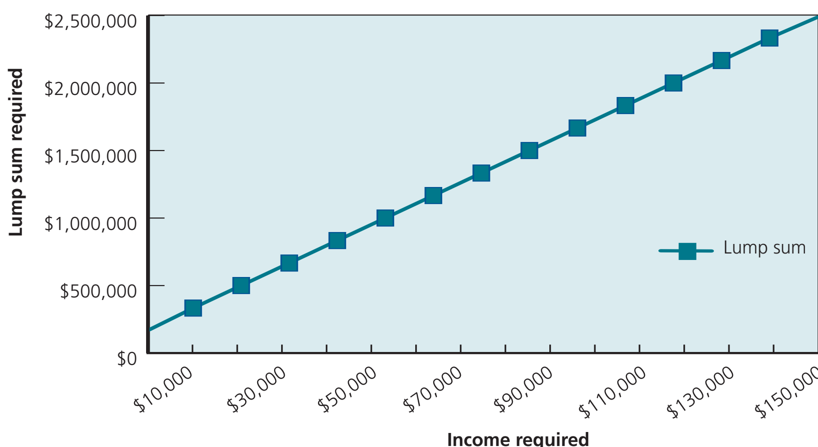
- downsizing their home;
- leaving a little bit less to their children; and/or
- postponing Andrew's retirement.

Over the next five years, Andrew and Joan would have to save $23,897 dollars per year (after tax) to meet their target of $270,000. This assumes they're reinvesting their interest and that all their investments (including their current super and share portfolio) return 6% (after tax).

To make this $23,897 payment after tax, Andrew would need to earn $42,296 (that's just over half of his gross salary).

However, instead of contributing after-tax dollars, Andrew could salary sacrifice to super (contributing pre-tax dollars into his super fund). To reach $670,000 within five years he'd need to salary sacrifice $28,114. This is pre-tax dollars and so is a more effective way to save – compare $28,114 to $42,296.

Note: The above example has been simplified for demonstration purposes.



Spouse contributions

Andrew could also make contributions to Joan's super fund. This would be beneficial for Andrew and Joan as it would set Joan up with a tax-effective income stream once they retire and it would ensure Andrew doesn't go over the Reasonable Benefits Limit (RBL) (see right). Andrew may also be eligible for a tax offset.

Reasonable Benefits Limit (RBL)

An RBL is a limit to the amount of concessionally taxed superannuation (or termination benefits) that an individual can receive during their lifetime. When creating a strategy for Andrew and Joan, it is another factor to be considered. Currently, the lump sum RBL is $648,946. If Andrew salary sacrifices into his super (an amount of $270,000 by the time he retires) and transfers the $100,000 in shares into his super as a deductible contribution, he may be over this RBL.

However, there are several strategies to overcome this potential problem:

1. Make some of the super contributions as spouse contributions into Joan's super fund
2. Convert the super fund into a pension (rather than receiving a lump sum payment), as the RBL for some pensions is $1,238,440
3. Apply to the ATO to apply for a transitional RBL
4. Keep the shares as separate investments
5. Make un-deducted contributions to his superannuation.
6. Consider splitting annual super contributions to Joan as per the 'super splitting' rules (introduced 1 January 2006).

	Year 1	Year 2	Year 3	Year 4	Year 5
Initial balance	$400,000	$447,897	$498,668	$552,485	$609,531
Contribution	$23,897	$23,897	$23,897	$23,897	$23,897
Earnings	$24,000	$26,874	$29,920	$33,149	$36,572
Final balance	**$447,897**	**$498,668**	**$552,485**	**$609,531**	**$670,000**

Risk insurance

Although Andrew and Joan have paid off their mortgage and have adult children, risk insurance would still help to protect them during Andrew's final earning years. Specifically, life insurance taken out in Andrew's name will ensure Joan can live comfortably well into her 80s and that the children are well provided for if Andrew dies in the next five years. In addition, income protection is also important to protect Andrew's earning potential.

We have identified that Andrew and Joan need to save a further $270,000 to meet their lifestyle objectives in retirement. Their savings plan for the next few years relies on Andrew's ongoing ability to work and earn an income. If he were unable to work due to an accident or illness they wouldn't be in a position to save. Consequently, it's important for Andrew to take out income protection insurance.

Income protection insurance is designed to replace up to 75% of a person's salary if they are unable to work due to an accident or illness. As a non-smoker (55-year-old, male scientist) Andrew's premium would be in the vicinity of $3,300 (fully tax deductible) for the first year, depending on the provider. This is based on a 30-day waiting period. If this were extended to 90 days the premium would fall to around $2,200. In the event of disablement, payments are made from the time the waiting or excess period has expired, until age 65 (assuming the accident or illness prevented him from working until that age).

Estate planning

Andrew and Joan want to have $670,000 savings (including super) to live off by the time Andrew retires. Their estate also includes their home, worth $400,000, and other smaller assets such as their car, household furniture, etc.

When setting up their wills, they should keep a few factors in mind. Specifically they should:

- ensure their wills and enduring powers of attorney are current and valid;
- both set up a binding nomination in their superannuation naming the other as the beneficiary; and
- set up testamentary trusts in their wills to:
  - protect their assets in the event that, after the death of Joan or Andrew, the remaining spouse remarries;
  - ensure that their assets are protected if their children divorce from their partners after the death of Andrew and/or Joan; and
  - protect their assets from Felicity's creditors if she goes bankrupt (Felicity runs her own interior design business).

Once a testamentary trust is set up, any funds or assets in that trust are owned by the trust, not the end recipient. As such, investments would be protected from, for example, Andrew or Joan's new spouse in the event of a remarriage; Janet's, David's and Felicity's ex-partners, in the event of any divorces; and Felicity's creditors if she goes bankrupt.

Consider Felicity's situation. Let's say Andrew and Joan die and leave Felicity $200,000 directly (not through a testamentary trust). If Felicity's interior design business then goes bankrupt, the business's creditors can call on that money to repay Felicity's business debts. A testamentary trust will ensure that Felicity, and only Felicity, receives her inheritance.

At Genesys, we want you to get the most out of life so you can take advantage of any opportunity and be prepared for any challenge – that's what wealth advice is all about.

Note: Advice contained in this flyer is general in nature, and does not consider your particular situation or needs. Please do not act on this advice until its appropriateness has been determined by a qualified adviser.

Looking for advice?

No matter what stage of life you're in, a wealth adviser can analyse your unique situation and help you make the most out of your finances. For more information on saving for your retirement, risk insurance, estate planning, etc., or to make an initial no-cost, no-obligation consultation, please contact contact:

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